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## CASE COMMENT

Lorna Richardson\*

Exercising a contractual right to terminate: what's good faith got to do with it?

In *Monde Petroleum SA v Westernzagros Ltd*<sup>1</sup> the English High Court<sup>2</sup> considered a number of issues arising from the entry into and subsequent termination of an agreement for consulting services to be provided by Monde to Westernzagros. Of particular interest is the Court's views on the purported termination of the parties' contract, and especially on the role of good faith in exercising a contractual right to terminate. These aspects of the case which will be the focus of this piece.

### A THE FACTS

Westernzagros (WZL) were seeking to enter into an exploration and production sharing agreement (EPSA) with the administration of the Kurdistan Regional Government, to explore oil and oil production in the Kurdistan region of Iraq. To assist them in entering into an EPSA, WZL entered into a consultancy agreement with Monde.<sup>3</sup> In terms of the agreement Monde agreed to perform such consultancy services as requested by WZL<sup>4</sup> including giving advice, support, and cooperation, as well as introduction services in relation to the public and private sector in the Federal Region of Kurdistan and Iraq. The consultancy agreement also required Monde to be proactive and use its initiative, connections and influence in the Federal Region of Kurdistan and Iraq.<sup>5</sup> In return for providing the consultancy services Monde would receive a retainer fee each month and would also receive a success fee on the happening of certain events.<sup>6</sup> The agreement also provided for an option of 3% in the EPSA in Monde's favour, in terms of which Monde would profit from any oil exploration and production undertaken under the EPSA. The option was only available to Monde once certain events had occurred including the receipt by WZL of a confirmation and support letter from the Government of Iraq to the EPSA.<sup>7</sup>

The consultancy agreement was entered into in April 2006. It was initially for a period of four months, or longer at WZL's election. It could be terminated by WZL on thirty days' notice to Monde if the EPSA did not become "fully operational and enforceable" within 6 months of the date of the consultancy agreement.<sup>8</sup>

Following a period of negotiations and failed attempts to agree an EPSA, an EPSA was eventually entered into between WZL and the Kurdistan Regional Government in

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<sup>1</sup> [2016] EWHC 1472 (Comm); 2016 SLT 131.

<sup>2</sup> Mr Richard Salter QC, sitting as a deputy judge.

<sup>3</sup> In evidence the individual running Monde, Mr Al-Fekaiki, noted that such contracts were to circumvent bribery laws in the West and were nothing more than kickbacks for local politicians – see para [159]. The Court found on the evidence that 75% of the money being paid to Monde by WZL was making its way to an official in the Kurdistan Regional Government (see para [160] – [164]) although the Court found the evidence did not establish that WZL knew the consultancy agreement was a sham (see paragraph [165]).

<sup>4</sup> Article 1 of the Agreement – see para [48].

<sup>5</sup> Schedule A of the Agreement – see para [49].

<sup>6</sup> Schedule B of the Agreement – see para [51].

<sup>7</sup> Schedules B and C of the Agreement – see paras [51] and [52].

<sup>8</sup> Article 10 of the Agreement – see para [54]. There were other grounds for terminating the consultancy agreement but this was the basis on which WZL had sought to terminate.

February 2007. The EPSA was formally ratified by the Regional Government, but no confirmation and support letter from the Iraqi Government was obtained.<sup>9</sup>

In March 2007 WZL served a notice purporting to terminate the consultancy agreement. In April 2007 Monde and WZL signed a termination and release agreement (TRA) regarding the termination of the consultancy agreement.

Monde challenged the validity of the TRA, arguing that they had been induced to enter into it by misrepresentation.<sup>10</sup> The Court found that Monde has been induced to enter the TRA by misrepresentations made on WZL's behalf, which entitled Monde to damages under s.2 of the Misrepresentation Act 1967.<sup>11</sup> That however, was not the end of the matter as the level of damages recoverable by Monde was effected by other questions, including whether WZL were otherwise able to terminate the consultancy agreement and whether they had, in fact, validly done so by the March 2007 termination notice.

## B THE ROLE OF GOOD FAITH WHEN EXERCISING A RIGHT TO TERMINATE

Monde argued that the consultancy agreement contained implied terms that *inter alia* WZL would not and could not exercise its right to terminate the consultancy agreement otherwise than in good faith.<sup>12</sup> In doing so Monde relied on the judgements of Leggatt J in *Yam Seng Pte Ltd v International Trade Corp Ltd*<sup>13</sup> and *MSC Mediterranean Shipping Co SA v Cottonex Anstalt*.<sup>14</sup>

The Court considered there to be “two insuperable obstacles” to Monde's case.<sup>15</sup> In the first place, even assuming that the parties intended the consultancy agreement to be a long-term arrangement (as Monde contended), it did not follow that it was necessary to imply any duty of good faith or other limitation constraining WZL's freedom to exercise the termination right.<sup>16</sup> The Court noted that there was no general doctrine of good faith in English contract law.<sup>17</sup> While a duty of good faith was implied by law in certain categories of contract, such as contracts between partners or where the parties' relationship was characterised as fiduciary, “in all other categories of contract... such a duty will only be implied where the contract would lack commercial or practical coherence without it”.<sup>18</sup> The Court noted that in *Yam Seng* Leggatt J had given some joint venture agreements, franchise agreements and long-term distributorship agreements as examples of contracts that might involve expectations of loyalty, which while not set out in the express terms of the contract, might be implicit in the parties' understanding of the agreement and necessary to give business efficacy to the arrangements. However, the Court stated “it is clear that

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<sup>9</sup> This remained the position to the date of the hearing – see para [347].

<sup>10</sup> This aspect of the case is discussed in paras [177] – [222].

<sup>11</sup> This Act applies to England and Wales only.

<sup>12</sup> Para [242].

<sup>13</sup> [2013] EWHC 111 QB; [2013] 1 Lloyd's Rep 526.

<sup>14</sup> [2015] EWHC 283.

<sup>15</sup> Para [247].

<sup>16</sup> Para [248].

<sup>17</sup> Para [249], citing *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland Ltd (t/a Medirest)* 2013 EWCA Civ 200.

<sup>18</sup> Para [249] citing *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72; [2015] 3 WLR 1843.

the mere fact that a contract is a long-term or relational one is not, of itself, enough to justify such an implication.”<sup>19</sup>

The Court found it impossible to identify any facts forming part of the commercial background or any aspect of the parties’ relationship<sup>20</sup> which indicated that the consultancy agreement lacked commercial or practical coherence without a good faith term being implied.<sup>21</sup> Furthermore, the agreement did not contain the sorts of mutual obligations and commitments that would be expected in the kind of relational contract where there were expectations of loyalty, which were implicit in the parties’ understanding of their agreement, that would justify implying a good faith term.<sup>22</sup>

The second obstacle for Monde was that the suggested good faith term was not concerned with the performance of the contract, but its termination.<sup>23</sup> For the Court,

a contractual right to terminate is a right which may be exercised irrespective of the exercising party’s reasons for doing so. Provided that the contractual conditions (if any) for the exercise of such a right (for example, the occurrence of an Event of Default) have been satisfied, the party exercising such a right does not have to justify its actions.<sup>24</sup>

While the authorities on this issue<sup>25</sup> were different in some ways from the present case the Court found that the principle recognised in *Lomas v JB Firth Rixon Inc*<sup>26</sup> was one of general application. The restrictions which Monde argued were implied terms of the contract simply did not apply to the exercise of a contractual right to terminate.<sup>27</sup> One reason for this was that a

contractual right to terminate ..is... not the exercise of a contractual discretion. Contractual discretions arise where there are a range of options from which to choose. A contractual right to terminate involves a binary choice.<sup>28</sup>

The purpose of a contractual right to terminate is the right to bring a contract to an end. The Court thought it was unlikely that the hypothetical reasonable commercial person would expect the party exercising the right to have to consult anyone’s interests but its own.<sup>29</sup> The Court noted that the common law had, for sound practical

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<sup>19</sup> Para [250], citing *Globe Motors Inc v TRW Lucas Varity Electric Steering Ltd* [2016] ECA Civ 396 and see the authorities reviewed in paras [251] – [254].

<sup>20</sup> On the issue of what factors could be taken into account in determining the parties’ common intention see paras [235] – [241].

<sup>21</sup> Para [255].

<sup>22</sup> Para [259].

<sup>23</sup> Para [260].

<sup>24</sup> Para [261].

<sup>25</sup> Analysed at paras [262] – [264].

<sup>26</sup> [2012] EWCA Civ 419.

<sup>27</sup> Para [265].

<sup>28</sup> Para [266], see the authorities reviewed at paras [267] – [270].

<sup>29</sup> Para [272]. It should be noted that in Scotland a landlord cannot irritate (terminate) a commercial lease for a non-monetary breach by the tenant where a fair and reasonable landlord would not do so in terms of s.5 of the Law Reform (Miscellaneous Provisions)(Scotland) Act 1985. It has been held that the fair and reasonable landlord

reasons, traditionally regarded certainty as a particularly important factor in relation to contractual termination provisions and, by avoiding any enquiry regarding the terminating party's motives or purpose, the common law sought to provide certainty.<sup>30</sup>

The Court found there were no implied terms in the consultancy agreement that restricted WZL's exercise of the contractual right to terminate. The Court then had to determine whether WZL had terminated the consultancy agreement.

## C THE VALIDITY OF THE TERMINATION NOTICE

The Court found that the termination notice issued by WZL in March 2007 was ineffective, as it did not purport to give thirty days' notice as required by the consultancy agreement.<sup>31</sup> However, the Court found that it would have been open to WZL at any later point in time to serve an effective termination notice. There was no immediate prospect of the Iraqi Government issuing the confirmation and support letter for the EPSA<sup>32</sup> which was required before the EPSA became fully operational and enforceable.<sup>33</sup> It was only when the EPSA became fully operational and enforceable that WZL's right to terminate on thirty days' notice would be lost.

The Court noted that in assessing damages account must be taken of all contingencies which might reduce or extinguish the loss. Where a party under a contract has an option, that would reduce or extinguish the loss, it was assumed that the party would exercise that option,<sup>34</sup> provided that would not result in him acting in an uncommercial way.<sup>35</sup> This meant that the damages Monde would recover in relation to WZL's misrepresentations leading to the signing of the TRA would be substantially reduced. Despite the termination notice in March 2007 not being effective to end the consultancy agreement, WZL could immediately thereafter have issued a valid termination notice.<sup>36</sup> As a result WZL's misrepresentations caused Monde no substantial recoverable loss.<sup>37</sup>

The Court held that serving the defective termination notice was not, in itself, a breach of contract by WZL. A defective termination notice would not usually be construed as a renunciation of the contract, unless looking at the circumstances from the perspective of a reasonable person in the position of the recipient of the notice, the party serving the notice had clearly shown an intention to abandon and refuse to perform the contract.<sup>38</sup> Given how limited WZL's obligations under the contract were

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considers the interests of the tenant as well as its own interests – see *Aubrey Investments Ltd v DSC (Realisations) Ltd (in receivership)* 1999 SC 21.

<sup>30</sup> Para [274].

<sup>31</sup> Paras [313] – [314].

<sup>32</sup> Para [316].

<sup>33</sup> See the discussion on the correct interpretation of this phrase at paras [294] – [309].

<sup>34</sup> Para [317] citing *Maredelanto Comania Naviera SA v Bergbau-Handel GmbH (The "Mihalis Angelos")* [1971] 1 QB 164.

<sup>35</sup> Para [317] citing *Durham Tees Valley Airport Ltd v bmibaby Ltd* [2010] EWCA Civ 485.

<sup>36</sup> One wonders whether that would have happened. Presumably WZL considered the March 2007 termination notice to be valid and, as such, they would have had no reason to issue a further valid termination notice.

<sup>37</sup> Para [318].

<sup>38</sup> Para [342], citing *Eminence Property Developments v Heaney* [2010] EWCA Civ 1168.

it did not seem to the Court that a reasonable person in Monde's position would have regarded the termination notice as "anything other than an attempt to operate the contractual machinery" regarding termination.<sup>39</sup> Monde would not have viewed the notice as a renunciation. The notice was simply of no legal effect<sup>40</sup> and did not result in a breach of contract by WZL.

## D CONCLUSIONS

This case is a further development in recent English case law regarding the role of good faith in contract law. Here the Court adopts a restrictive approach, making clear that good faith has a role to play in certain types of contract only. The fact that a contract is a long-term or relational contract is not, without more, sufficient justification for implying a term of good faith. The case seeks to set the boundaries for the role of good faith in contract law, drawing on recent Supreme Court authority,<sup>41</sup> that a term can only be implied into a contract where needed for business efficacy. Where the contract could work without the term there is no basis on which to imply it. This case may mark a watershed in the willingness of English judges to imply a term of good faith into contracts following Legatt's J's comments in *Yam Seng*.<sup>42</sup> [but see other cases where not allowed - *National Private Air Transport Services Co (National Air Services) Ltd v Creditrade LLP* [2016] EWHC 2144 (Comm) and *Carewatch Care Services Ltd v Focus Caring Services Ltd and Grace* [2014] EWHC 2313 (Ch) – have a quick look at them and amend this – that Monde part of turning of tide / jud scepticism towards implying GF term?]

The case also highlights the limited effect a good faith term would have on the exercise of a contractual right to terminate. The right to terminate is different from the performance of obligations under the contract. It is not the exercise of a discretion, involving one of a number of possible options, but a binary choice – to terminate or not. Drawing on the Court of Appeal's *obiter* comments in *Lomas*<sup>43</sup> the Court held that a right to terminate can be exercised as long as the conditions for its exercise are satisfied, without the party who terminates having to justify its decision to do so. If restrictions are to be placed on a party's right to terminate these will have to be expressly provided for. That no evaluation needs to be carried out of a party's decision to terminate (beyond checking that the conditions provided for in the contract for the right to be available have been satisfied) is beneficial given the need for commercial certainty, particularly surrounding the question of whether the parties' contract has come to an end. Were this not the case the right to terminate would be worth significantly less to the party having the right than it currently has.

Finally, the Court suggests that a defective notice to terminate is unlikely to put the party serving it in breach of contract where the notice is served in exercise of a contractual right to end the contract. The Court found that in this case a reasonable

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<sup>39</sup> Para [343].

<sup>40</sup> Para [342].

<sup>41</sup> *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72; [2015] 3 WLR 1843. For comment see D Cabrelli, "Implying Terms in law: *Belize* no more?" 2016 20(3) Edin LR 338.

<sup>42</sup> [2013] EWHC 111 QB; [2013] 1 Lloyd's Rep 526. See for instance *Emirates Trading Agency LLC v Prime Mineral Exports Private Ltd* [2014] EWHC 2104 (Comm); and *British Groundschool Ltd v Intelligent Data Capture Ltd* [2014] EWHC 2145 (Ch).

<sup>43</sup> [2012] EWCA Civ 419.

person in Monde's position would not have considered WZL to have clearly shown an intention to abandon and refuse to perform the contract.<sup>44</sup> It is suggested that in many instances a party purporting to terminate a contract is in doing so demonstrating its intention not to perform its obligations under the contract going forward. It is suggested that parties and their agents rely on this aspect of the case with some care.

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<sup>44</sup> Para [342].